

VZCZCXRO0936
PP RUEHGR
DE RUEHKG #0405/01 1421146
ZNR UUUUU ZZH
P 221146Z MAY 09
FM AMEMBASSY KINGSTON
TO RUEHC/SECSTATE WASHDC PRIORITY 7647
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
INFO RUCNCOM/EC CARICOM COLLECTIVE

UNCLAS SECTION 01 OF 03 KINGSTON 000405

SENSITIVE
SIPDIS

STATE FOR WHA/CAR (ACADIEUX)(VDEPIRRO)(WSMITH)
WHA/EPSC (MROONEY) (FCORNEILLE)
EEB/ESC/IFD/EPC (McMANUS)
INR/RES (RWARNER)
INR/I (SMCCORMICK)
WHA/PPC (JUAN GONZALEZ)
EEB/IFD/OMA (RMERRIN)
SANTO DOMINGO FOR FCS AND FAS
TREASURY FOR ERIN NEPHEW
EXIM BANK FOR ANNETTE MARESH
USTDA FOR NATHAN YOUNG AND PATRICIA ARRIAGADA
OPIC FOR ALISON GERMAK

E.O. 12958: N/A
TAGS: [ECON](#) [TRY](#) [ENRG](#) [EFIN](#) [EINV](#) [ETRD](#) [ECIN](#) [EAIR](#) [IADB](#) [IBRD](#)
UNDP, IMF, KCOR, KIPR, XL, JM
SUBJECT: JAMAICA IN ECONOMIC SURVIVAL MODE

REF: A) KINGSTON 361
B) KINGSTON 325
C) KINGSTON 315
D) KINGSTON 306
E) KINGSTON 245

SUMMARY

1. (SBU) Jamaica's gargantuan debt, falling external earnings, and fiscal imbalance have placed it in a precarious position. Harsh global conditions have rendered the Government of Jamaica's (GOJ) medium-term macroeconomic framework useless, and have forced an increase in the stock of debt to augment slowing revenues. In addition to pushing up interest rates, the higher borrowing has burdened the fiscal position. This, combined with falling revenues from external sources, have led to worsening fiscal dynamics. As options have narrowed, Prime Minister (PM) Bruce Golding has been forced to enact a number of stern measures. Public sector workers have been given the choice of a wage freeze or job cuts. Add in talks about debt restructuring, albeit speculative, and the severity of the situation intensifies. The measures being taken may not be sufficient to slow the tide, and it might be only a matter of time before the GOJ re-engages the IMF. A previously scheduled IMF delegation will arrive at the end of May for a two week visit. End Summary.

Missed Targets, New Forecast

2. (SBU) Confronted with the challenges emanating from the global crisis, the Jamaican economy contracted by 0.6 percent in 2008, down from the 1.2 percent in 2007. The outturn was also well below the medium term target of 3-4 percent. Inflation of 12.4 percent for the fiscal year was well below the 19.9 percent registered for the last fiscal year, but it outpaced the original projected target of 5-6 percent. The GOJ's operations also generated a fiscal deficit of 5.6 percent of GDP, above the 3 percent target. As the global economy is expected to remain depressed, the GOJ is forecasting further economic contraction of 2.5 to 3.5 percent during 2009-10. Inflation is expected to be in the range of 11-14 percent, while the fiscal deficit is budgeted at 5.5 percent of GDP. This represents a total revamp of the medium term macroeconomic framework, which had programmed a balanced budget by 2009-10, and points to the challenges facing the country.

Economic Fallout Intensifies

13. (SBU) The economic fallout has continued into 2009 as real GDP declined by 2.8 percent during January to March, with only agriculture (up 13.3 percent) and financial services (up marginally) registering growth. Inflation moderated to 1.3 percent, but policy based inflation is expected to increase significantly in the next quarter on the back of the tax package implemented in April (reftel C). The fiscal deficit was USD 210 million, which is unusual, since most revenues are collected in the period. During the quarter there was also a 15 percent depreciation in the local currency, while remittances declined by 15 percent to USD 414.6 million. The GOJ announced the introduction of a new 5,000 Jamaican dollar note on May 18, worth about USD 56.5; the highest prior note was 1,000 (USD 11.3), released in 2001.

Bauxite Taken Down, Taps Out

14. (SBU) The impact of the crisis has been felt most in the mining sector, which declined by 28.2 percent during the quarter, reflecting declining global demand for the country's major merchandise export. This has resulted in a near collapse of the once lucrative bauxite/alumina sector, as three plants (owned by UC Rusal of Russia and Norsk Hydro of Norway) have ceased operations (reftel B). The implications are far reaching, as almost 2,000 of the country's most skilled and well paid workers have found themselves unemployed. The once thriving towns around the bauxite belt are also expected to stagnate as demand for goods and services wanes. GOJ revenues have also taken a hit, forcing the

KINGSTON 00000405 002 OF 003

implementation of a USD 285 million tax package. So dramatic is the fallout in the sector that Minister Without Portfolio in the Ministry of Finance, Don Wehby, has suggested that if tourism and remittances fall off and oil prices increase, the country's stock of Net International Reserves (NIR) could halve (USD 800 million) by March 2010. (NOTE: This would be a worst case scenario; before it occurred a return to the IMF would have been triggered. END NOTE). Although tourism earnings have remained flat, remittances have been declining for the first time, by fully 15 percent in the first quarter of 2009.

Debt Climbs...

15. (SBU) In order to augment slowing revenues, the GOJ also has also been forced to resort to the unpopular solution of increased public borrowing. For the 2008/09 fiscal year, public borrowing exceeded the initially budgeted amount by USD 326 million. This had the effect of adding to the already gargantuan debt stock, which increased by 13 percent to USD 12.7 billion. (NOTE: A majority of the debt is locally held; Jamaican financial institutions hold 53.85 percent of the GOJ debt. END NOTE). However, the debt-to-GDP ratio moderated to 107 percent from 140 percent three years ago, highlighting the significant positive impact inflation has had on the ratio over the period. GOJ borrowing continues to push up interest rates (up to 24 percent) and by extension crowd out private sector borrowers, thus starving potential future business growth. (NOTE: Several medium sized business owners have complained to Emboffs about the high cost of credit and its stymieing effect on business deals. END NOTE).

... And Exceeds Revenue

16. (SBU) Debt servicing costs, which had been trending down to fifty percent of the budget, have now given up those gains and have jumped back to 56 percent. At this level, debt serving costs (interest and principal payments) exceed the total revenue intake, forcing the GOJ to borrow to finance all other expenditure items. The fact that the GOJ has still not privatized major loss making parastatals like Air Jamaica and the Sugar Company of Jamaica makes the balance sheet looks even worse. If one adds in the significant amount of

contingent liabilities (loan guarantees) associated with these same companies, the effective debt-to-GDP ratio could well near 150 percent.

Golding: Raises Taxes, Talks Tough

¶7. (SBU) As debt costs again absorb a greater portion of the budget, the GOJ has embarked on another round of fiscal juggling. Although capital expenditures are being cut, the Golding administration also has announced a public sector wage freeze (reftel A). Public sector wages of USD 1.3 billion doubled over the last six years to become the second largest call on the budget, and a wage adjustment for the current period would have added a further USD 43 million to the bill. In light of this, Golding was left with little choice but to stand up to the country's powerful trade union grouping in the face of mounting pressure. He went as far as telling some protesting workers and their unions that his administration would not be bullied. He said in a press conference, "This Government is not going to be cowered, is not going to be yielding, and is not going to be genuflecting, simply because people believe they have a kind of power that can hold the country to ransom."

¶8. (SBU) He also signaled his intention to contain spending by having Permanent Secretaries monitor and report on expenditures quarterly. In a token attempt to control the wage bill, he also announced a policy to contain employment growth by leaving non-critical vacancies unfilled and, where possible, retiring some posts (reftel A). He also took a decision to reduce the USD 2.5 million in annual rent being incurred by GOJ entities by mandating that some offices move to the 269,000 square feet of empty government-owned space.

Debt Restructuring Debated

KINGSTON 00000405 003 OF 003

¶9. (SBU) The narrowing menu of options also led UNDP resident representative Minh Pham to publically initiate a discussion on April 5 on the benefits of debt restructuring. This idea has found resonance among trade unionists and some analysts, who have been arguing for the holders of capital to absorb some of the burden of fiscal adjustment. Pham said his agency was willing to provide a forum for dialogue between the GOJ and its domestic creditors to work out a plan for proposed debt rescheduling. But even this approach could be challenging, given that successive governments have guarded, and even boasted about, their creditworthiness.

¶10. (SBU) Pham has argued that with each Jamaican owing about USD 5,000 of the debt, there is a need to look at how the country balances the interests of the few creditors with that of the needs of the population in order to find a win-win solution. However, most of the domestic institutional creditors appear unwilling to accept this option, positing that it could curtail access to credit for a long time and/or lead to further downgrades by rating agencies. The GOJ has a long history of paying its debt and does not want to have the blemish of asking for debt write offs or forgiveness on its record. Against this background, it is unlikely that the debt hungry GOJ will pursue this approach. (NOTE: If the situation continues to worsen, there is a chance that some debt holder may voluntarily take a slight reduction in interest owed to ease pressure on the GOJ's debt payment, in keeping with the idea that a healthier Jamaica with requisite public funds for schools, crime prevention, and health care will be more likely to grow the economy and tax revenue and thus successfully repay the loans. END NOTE).

IMF Dialogue

¶11. (SBU) Therefore, despite the reluctance, the GOJ appears to be left with little option but to return to the IMF. However, the timing of this decision might have to be dictated by the economic imperatives, as Golding has suggested that he is reluctant to negotiate an IMF program. This is understandable, since Jamaicans

remain wary of the IMF because of the conditions once associated with the Fund's lending programs. Wehby, who along with Central Bank Governor Derrick Lattibeaudiere held a dialogue with the IMF in early May, explained that the meeting with the IMF had been merely exploratory, geared towards sourcing alternative funding should the need arise. "What it (was) is planning if there is a worse case scenario in Jamaica how are we going to satisfy our external needs," he revealed. "A direct benefit of the exploratory meeting with the IMF, is that the NIR could be boosted by up to USD 300 million", Wehby continued. But a Senior Director at the BOJ told Emboffs that the GOJ should immediately engage the IMF before the funds contributed by the G20 deplete. She said Lattibeaudiere, although reluctant in principle, is interested in an IMF program given the perilous state of the external accounts. In this regard, months ago he gave instructions to his technocrats to put numbers together in preparation for a program.

Comment

¶12. (SBU) With Jamaica yet to face the full extent of the global recession, there is every likelihood that the economic dynamics could deteriorate further, leading to another bout of instability. External accounts face the greatest danger, given the decline in export earnings even as imports remain high. In essence, the country could face a balance of payments (BOP) crisis, leading to further depreciation in the local currency. In addition to depleting the stock of NIR, further depreciation will only serve to drive up inflation and keep interest rates high. But this eventuality could well accelerate a return to the IMF, which, while feared by most Jamaicans, could provide the impetus for some of the structural changes required to revive the moribund economy. END COMMENT.
HEG